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In the Supreme Court of the United States

OCTOBER TERM, 1973

BERNICE ESPY HICKS, AS SPECIAL FIDUCIARY OF THE ESTATE OF PEARLE M. ESPY, DECEASED,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

THEODORE T. PECK
Attorney At Law
921 Equitable Building
Denver, Colorado 80202

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UNITED STATES OF AMERICA,

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Your petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Tenth Circuit entered in the above entitled cause on October 30, 1973, affirming a judgment of the United States District Court for the District of Colorado on December 23, 1971, which denied petitioner's claim for a federal estate tax refund.

CITATION TO OPINION BELOW

The opinion of the United States District Court for the District of Colorado is reported at 335 Fed.Supp. 474 and appended hereto as Appendix A (infra, pp. A-1 - A-15). The opinion of the Court of Appeals, not yet reported, is appended hereto as Appendix B (infra, pp. B-1 - B-8).

JURISDICTION

The judgment of the Court of Appeals was entered on October 30, 1973. The jurisdiction of this Court is invoked under 28 USC 1254(1).

QUESTIONS PRESENTED

In determining, for federal estate tax purposes, the fair market value of stock in two affiliated operating close corporations, the district court substituted estimated current liquidation value for purposes unrelated to corporate operations for book value of the real estate owned and used by the corporations in the normal course of their business. The corporations are not family holding companies but, rather, operating manufacturing companies. Without addressing itself to the petitioner's contention that the stock should be valued as that of operating companies as distinguished from family holding companies, the circuit court affirmed. The questions presented for review are:

1. Whether the court of appeals erred in failing to distinguish between operating companies, which earn money and pay dividends, and family holding companies, which merely collect revenues, when reviewing the district court's ruling on the fair market value of shares in these operating close corporations.

2. Whether, in determining for federal estate tax purposes the fair market value of unlisted and untraded shares in these operating close corporations, it was proper to overlook the book value of assets used by the corporations in the normal course of their business and to substitute therefor estimated liquidation values of such assets for purposes unrelated to the business of the corporation.

TREASURY REGULATION INVOLVED

The Treasury Regulation involved is 26 C.F.R. § 20.2031-2(f). It is appended hereto as Appendix C. (Appendix p. C-1).

STATEMENT

This petition involves an alleged overpayment of federal estate taxes in the amount of $92,083.94. The decedent died on October 2, 1966, owning 7,600 shares of Espy Ice Company (Espy) outright and possessing a power of appointment over an additional 3,500 shares of Espy. When combined, these shares constituted approximately 52 percent of the outstanding shares of Espy, a Colorado corporation, an amount less than the two-thirds required by Colorado law for the disposal of property other than in the normal course of business. The decedent also possessed a power of appointment over 138 shares of City Ice Company (City). On October 2, 1966, both Espy and City were, as they had been and still are, small affiliated family-owned companies actively engaged in the business of manufacturing ice and selling ice products and cold storage services.

Petitioner filed a federal estate tax return on January 2, 1968, showing a tax due of approximately $137,500.00, and this tax was paid. A deficiency of approximately $52,600 plus interest of approximately $6,600 was assessed, and the total deficiency was paid on April 7, 1970. Following the denial of a timely claim for refund, the petitioner filed action for refund. Trial was commenced and concluded on November 3, 1971, and judgment was entered on December 23, 1971. Notice of Appeal was filed by the petitioner on February 17, 1972, and oral argument was heard on October 15, 1972. The opinion of the Circuit Court was entered on October 30, 1973 affirming the dismissal of petitioner's claim for refund.

On trial before the district court, petitioner's fundamental assertion that both Espy and City are operating companies rather than holding companies was not contested, and the district court's opinion is silent on this basic point. This first became an issue upon appeal. Petitioner's basis for appeal in the circuit court was that Espy and City are operating companies rather than family holding companies and therefore that the fair market value of the stock of Espy and City should be determined on basis of the corporations' earnings and dividend paying capacity rather than on basis of the piecemeal

liquidation of its assets as if such assets were mere investments in the portfolio of a holding company. Petitioner's two briefs and oral argument in the court of appeals were devoted almost entirely to the issue of evaluating the stock of an operating close corporation as distinguished from the stock of a holding company, but the circuit court's opinion touches only briefly but summarily upon this issue. (Appendix p. B-6). Without distinguishing between operating companies and holding companies or even examining the need for distinguishing between such types of companies for federal estate tax purposes, the circuit court merely held that the net worth of the real estate assets of these closely held operating companies was properly considered when determining the fair market value of the stock of the corporations. In support of this position, the circuit court cited two cases involving family holding companies and a third case which turned on another issue. (Appendix p. B-6).

In the district court, the government had stressed the current high market value of Denver and Colorado mountain real estate for recreational and other purposes as its basis for the greatly increased market value it placed on the real estate that Espy and City own and use in their business operations. This greatly increased market value of land, even though speculative and for purposes unrelated to the corporations' business operations, was the basis for the government's estimated fair market value of Espy's and City's shares of stock. (Appendix pp. A-2 - A-3). The petitioner, however, urged that earnings and dividends are the proper factors to consider when determining the fair market value of an operating company which is not selling off any of its property. (Appendix p. A-3). Thus, the district court used and the circuit court accepted values estimated for purposes entirely unrelated and foreign to petitioner's ice making business. The petitioner used its own book value for these assets and determined the fair market value of the stock on basis of the corporations' earnings and capacity to pay dividends as operating companies. The district court, without questioning petitioner's status as an operating company, nevertheless rejected petitioner's values and adopted those urged by the government. (Appendix p. A-3). The circuit court

merely affirmed without recognizing any difference between operating companies and family holding companies. (Appendix p. B-6). The circuit court only mentioned that a government witness before the trial court considered one of the corporations to be a "not wholly operating company" because it had valuable assets apart from its principal business. (Appendix p. B-5). This, however, is not mentioned in the district court's opinion, but it was raised by the government in oral argument before the circuit court. Espy does retain some property that modern technology has temporarily removed from an active role in the ice manufacturing business, but both Espy and City have derived approximately seventy-five percent of their earnings from their respective manufacturing operations since 1962. They qualify as operating companies under every known standard including those set forth in Sections 542 and 543 of the Internal Revenue Code.

REASONS FOR GRANTING THE WRIT

This case presents two questions worthy of further consideration in order to resolve apparent conflicts which may arise to compromise the orderly administration of justice as the result of the judgment entered by the circuit court in this case:

There Appears To Be A Conflict Between The Tenth Circuit And The U.S. Court Of Claims In Determining The Fair Market Value Of Unlisted And Untraded Securities For Federal Tax Purposes

By affirming the district court's judgment in this case, the United States Court of Appeals, Tenth Circuit, has adopted a method of determining the fair market value of unlisted and untraded securities for purposes of federal estate taxation that appears to be in substantial conflict with the standards for such determination used by the United States Court of Claims. In the Tenth Circuit, the standards set forth in *Central Trust Company, et al vs. The United States*, 305 F.2d 396 (U.S. Court of Claims, 1962) no longer seem to be followed. In the *Central Trust* case, *supra*, the

Court of Claims emphasized corporate earnings and dividends as the salient factors to be considered in the determination of the fair market value of shares of stock in a close corporation. In this case, however, the Tenth Circuit has adopted the district court's emphasis on speculative liquidation values of the close corporations' underlying assets as the principal measure of value. These two measures of value, when applied to the stock of a close but operating corporation, are so inconsistent and mutually frustrating as to require the designation of either one or neither of them as the proper standard to be followed by the United States courts.

In conformance with its decision in the *Central Trust* case, *supra*, the Court of Claims again emphasized earnings and dividends as the proper criterion for evaluating unlisted stock in *Righter vs. United States*, 439 F.2d 1204, 1210 (1971). The *Righter* case, *supra*, was thereafter cited and followed in *Korslin vs. U.S.*, 31 AFTR2d (ED, Wisconsin, 1973). A similar result is to be found in *Estate of Ethel C. Dooly, et al*, ¶72, 164 P.H. Memo TC (1964).

The Thrust Of The Circuit Court's Decision In This Case Is At Odds With The Purpose Of The Federal Antitrust Laws

This is an instance which illustrates a possible conflict between the operations of the federal estate tax laws and the federal antitrust laws. Efforts to encourage or enforce compliance with Section 7 of The Clayton Act or Section 2 of The Sherman Act, both of which are intended to prevent anticompetitive concentrations of economic power by means of mergers or attempts to monopolize interstate trade and commerce, may be partially frustrated by any unreasonable interpretation of the federal estate tax law which unnecessarily encourages such concentrations of power.

When an owner of an operating close corporation, such as Espy or City, is faced with the prospect of eventual federal estate taxation of its unlisted and untraded shares of stock based upon the piecemeal liquidation of the corpora-

tion's individual assets at speculative prices suitable for uses entirely foreign and unrelated to the business of the corporation, acquisition by another company becomes an attractive means to avoid unnecessary taxation and to provide liquidity for the family estate.

There has been considerable concern in antitrust circles, both government and private, about the growing tendency within recent years and the presently high rate of mergers and consequent reduction of competition because of growing concentrations of power throughout the national economy.

Stock of close corporations which operate to earn money and pay dividends to their investors ordinarily seems to be taxed at considerably higher values than listed securities for which there are definitely established price quotations to show fair market value. Serious efforts to establish the fair market value of unlisted shares of stock in closely held operating companies are necessarily difficult because of the lack of any recognized market for such shares, but a reasonable market value can at least be approached through consideration of known factors such as the corporations' earnings and payment of dividends. However, when a wholly imaginary market with speculative sales values for uses unrelated to the operations of the corporations is substituted for known earnings and dividends, the risk of unreasonably high taxation looms as a good reason and powerful motive for the small businessman to seek buyers for his company and to take cash or readily merchantable securities in exchange for his ownership of a small business of uncertain but highly taxable value. Thus, refuge in merger becomes the lesser of two evils for the small businessman, and concentration of economic power is fostered through mergers which provide an escape from a type of federal estate taxation which is known to be high but which cannot be reasonably calculated through reference to operating figures which show the actual value of the corporation as a going concern.

Thus, the proscriptions and sanctions of Section 7 of The Clayton Act and, to a somewhat lesser degree, Section 2 of The Sherman Act appear to be inconsistent in effect with U.S.

Treasury Regulations, Section 20.2031-2(f) as such Treasury Regulation has been interpreted and used by the circuit court to establish the fair market value of shares of Espy and City stock in this case.

CONCLUSION

For all of the foregoing, this petition for a Writ of Certiorari should be granted.

RESPECTFULLY SUBMITTED,

THEODORE T. PECK
921 Equitable Building
Denver, Colorado 80202
Area Code 303: 222-9743
Attorney for Petitioner

Appendix A

MEMORANDUM OPINION

WINNER, Judge

This memorandum opinion contains the findings of fact and conclusions of law required by Rule 52. In this case, jurisdiction is based on 28 U.S.C. §1346, and plaintiff here seeks to recover estate taxes paid on the estate of Pearle M. Espy, who died October 2, 1966.

There are two basic questions to be determined. The first is the value of shares of stock owned by decedent in two closely held corporations, Espy Ice Company and City Ice Company. The second is the valuation of 574 shares of The Colonial Fund, Inc., a mutual fund. Most of the dollars involved have to do with the value of the Espy Ice and City Ice stock, but the difficult legal question is how to determine the value of the mutual fund shares, and the validity of a Treasury regulation saying how such shares must be valued.

Plaintiff filed a federal estate tax return on January 2, 1968, showing a tax due of $137,503.23, and this tax was paid. A deficiency was assessed in the amount of $52,579.74, plus interest in the amount of $6,615.68. The total deficiency of $59,195.42 was paid on April 7, 1970. A timely claim for refund was filed and denied. This suit followed.

We first consider the value of the Espy Ice Company and City Ice Company stock. On the date of her death, decedent owned outright 7,600 shares of Espy Ice, and she possessed a power of appointment over an additional 3,500 shares of that company's stock. The stock she owned outright, when combined with the stock over which she had a power of appointment, constituted approximately 52% of the outstanding stock of Espy Ice Company. Decedent was possessed of a power of appointment over 138 shares of City Ice stock, and Espy Ice owned 1,148 shares of City Ice. The shares of City Ice owned by Espy Ice and the shares of City Ice over which decedent possessed a power of appointment constituted approximately 49% of the outstanding stock of City Ice Company.

Each party called a valuation witness, and the value of the Espy Ice Company and City Ice Company stock must be determined by the Court based on the testimony of those witnesses. It may serve to put the case in focus if the values shown by the tax return, the values determined by the Commissioner, and the values testified to by the witnesses are put in tabular form. Those values, tabulated, are:

	Espy Ice Stock	City Ice Stock
Estate tax return	$25.00	$210.00
Commissioner's valuation	37.44	450.00
Plaintiff's witness (Uhl)	13.70	126.09
Defendant's witness (Green)	41.75	306.00

Much of the underlying value of the stock in the two companies is in the value of certain company owned real estate. The government called a second witness, a qualified appraiser, Chase, who testified to the fair cash market value of the real estate owned by the two companies, but plaintiff offered no such valuation or appraisal testimony as to the real estate. Plaintiff's only witness valued the corporate stock using the book value of the real estate, and, as we shall see presently, this was a completely unrealistic approach to value. The real estate had been owned by the companies for many, many years, and no consideration was given by plaintiff's witness to any appreciation in value of industrial Denver real property and the sky rocketing values of prime mountain property having potential for subdivision. Also, the testimony showed that a part of one piece of the mountain property had been condemned by the Colorado Department of Highways, and $13,000 has been paid as the condemnation value of this part. Yet, plaintiff's witness valued the substantial remainder of that same property at $1.00. Plaintiff's witness testified to a value of all of the real estate applied to its present use and he used only depreciated book values of the real estate in valuing the corporate stock. He at no time gave any thought to the true value of the real property owned by Espy Ice and City Ice. Using the value theories applied by plaintiff's witness, real property having an October 2, 1966, fair cash market value of $1,000,000 would be valued by him at its original cost,

even though that cost might be only $25,000, and it would be valued on the basis of its applied use, even though that use was a far cry from its highest and best use. Plaintiff's valuation witness never did take into account the fair cash market value of substantial assets owned by the two corporations. It was very doubtful that his conclusions were admissible in evidence, but because he was plaintiff's only witness, the Court permitted him to testify to his conclusions. However, the Court cannot and does not accept those value conclusions.

Defendant's witness approached the problem differently He did consider the true value of the real property as testified to by the witness Chase. He then considered sales of listed stocks of ice and cold storage companies, and made suitable and reasonable adjustments to arrive at the value of the stocks of comparable closely held corporations. He did not use a capitalization of income approach, but the Court on its own capitalized the income of the companies and adjusted for the value of the real estate as testified to by Chase. The approach used by the Court as a check against the government's expert produced remarkably similar (although somewhat higher) results to those testified to by the defendant's expert.

Based upon all of the evidence in the case, the Court accepts the testimony of defendant's witness and finds that on October 2, 1966, the value of the stock of Espy Ice Company was $41.75 per share and that the value of City Ice Company on that date was $306.00 per share. In making this finding, the Court is not unaware of the fact that plaintiff undertook the burden of proving that the Commissioner's valuation was wrong and that some other value was correct. Plaintiff did not actually meet her burden, and it may be that technically the Court should permit the $450 per share value determined by the Commissioner for the City Ice Company stock to stand, but this the Court cannot do as a matter of fairness. Accordingly, the Court finds the values of the stock of Espy Ice Company and City Ice Company to be those testified to at time of trial by defendant's witnesses rather than those determined by the Commissioner.

Having decided the issues in the case applicable to almost all of the dollars involved, we pass to the truly knotty problem which arises in connection with a $363.05 difference between

the tax return value and the Commissioner's determined value of the 574 shares of Colonial Fund. The tax on this $363.05 difference in value is of not much monetary importance to either party, but the valuation principle to be applied is of great importance to defendant and to all owners of investment trust shares. It is because of the importance of the question that the Court permitted intervention by the mutual funds named in the caption of the case, because it is unlikely that plaintiff can afford the luxury of appearing in the Court of Appeals for the small amount involved.

The tax return valued the Colonial Fund shares at $12.00075 per share. The Commissioner determined the value to be $12.64 per share. Thus, the return showed the shares to be worth $6,892.31, and the Commissioner says that they are worth $7,255.36, which provides us with the $363.05 difference in valuation which is in dispute. The $6,892.31 is the amount for which decedent could have redeemed the 574 shares on the date of death. The $7,255.36 is the amount it would have cost to buy those shares on that date. Undeniably, the Commissioner's valuation is correct if Regulation 20.2031-8 is reasonable and can be upheld. That regulation says:

> "§ 20.2031-8 *Valuation of certain life insurance and annuity contracts; valuation of shares in an open-end investment company.*
>
> . . . . . .
>
> "(b) *Valuation of shares in an open-end investment company.* (1) The fair market value of a share in an open-end investment company (commonly known as a 'mutual fund') is the public offering price of a share, adjusted for any reduction in price available to the public in acquiring the number of shares being valued. In the absence of an affirmative showing of the public offering price in effect at the time of death, the last public offering price quoted by the company for the date of death shall be presumed to be the applicable public offering price. If the alternate valuation under § 2032 is elected, the last public offering price quoted by the company for the alternate valuation date shall be the applicable public

offering price. If there is no public offering price quoted by the company for the applicable valuation date (e.g., the valuation date is a Saturday, Sunday, or Holiday) the fair market value of the mutual fund share is the last public offering price quoted by the company for the first day preceding the applicable valuation date for which there is a quotation, adjusted for any reduction in price available to the public in acquiring the number of shares being valued . . . .

"(2) The provisions of this paragraph shall apply with respect to estate of decedents dying after October 10, 1963."

This regulation, which is of 1963 origin, must be read against the basic concept that estate tax valuations are based on fair market value as is emphasized by the older §20.2031-1 of the regulations, and the government's problem, simply stated, is to justify a regulation which taxes mutual fund shares at a value higher than any owner can realistically expect to receive for them. The government must justify this special treatment of shares of an investment trust fund in the full light of the general valuation principles expressed in §20.2031-1 of the regulations, which are:

"The value of every item of property includible in a decedent's gross estate . . . is the fair market value thereof . . . . The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of the relevant facts. The fair market value of a particular item of property includible in the decedent's gross estate is not to be determined by a forced sale price. Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item wherever appropriate. Thus, in the case of

> an item of property includible in the decedent's gross estate, which is generally obtained by the public in the retail market, the fair market value of such an item of property is the price at which the item or a comparable item would be sold at retail. . . . All relevant facts and elements of value as of the applicable valuation date shall be considered in every case . . . ."

We are not the first court to face the problem, but, because the regulation in question was not adopted until 1963, there is not a plethora of authority passing on the question, and the matter has not been considered by the Supreme Court.

The first court to which the problem was presented was the Tax Court of the United States. In *Estate of Wells*, (1968) 50 T.C. 871, the regulation was upheld by football score majority of 7 to 6. The majority opinion analogized the valuation of investment trust shares to life insurance contracts and to a comparison with the surrender value and purchase price of such contracts. The majority in *Estate of Wells* also upheld the regulation by comparing the valuation of investment trust shares to the use of replacement cost in valuing property for gift tax purposes. It was said:

> "It has often been held that Treasury regulations are to be sustained unless they are found to be unreasonable and plainly inconsistent with the revenue statutes. Commissioner v. South Texas Lumber Co. (1948) 333 U.S. 496.
>
> "In formulating the regulations relating to valuation, open-end investment company shares were included by the Treasury in § 20.2031-8 along with 'certain life insurance and annuity contracts,' rather than in § 20.2031-2, 'valuation of stocks and bonds,' which set the value of the latter at the 'mean between the highest and lowest quoted selling prices.' Petitioner argues that this is a significant inconsistency which makes the regulation with which we are concerned of doubtful validity.

"We think this organization of the regulations was no more than recognition that investment company shares are a different breed of cats from ordinary stocks and bonds; and when it comes to valuing them, a different criterion can reasonably be applied, more nearly like that applied to life insurance and annuity contracts than stocks and bonds."

The 6-judge minority of the Tax Court was unable to buy this reasoning, and Judge Tannenwald's dissent pointed out:

"I do not dispute the principle that respondent's regulations should be sustained unless they are unreasonable. But it does not follow that, because repondent has a choice of alternatives, his choice should be sustained where the alternative chosen is unrealistic. In such a situation the regulations embodying that choice should be held to be unreasonable. In my opinion, the regulations involved herein are clearly unrealistic as applied to the factual situation involved herein and therefore to that extent unreasonable.

"The touch stone of fair market value has always been the price which a willing seller could reasonably be expected to be able to obtain from a disposition of the property in question. Thus, if shares of stock are subject to a binding restriction, which is the product of an arm's-length transaction, that the shares may not be sold without offering them to a third person at a certain price, that price becomes the ceiling for determining the fair market value of the shares for estate tax purposes . . . .

"In the life insurance cases, the courts were obviously influenced by the facts that the insurance is a different 'breed' due to the element of insurability, or the lack thereof, of the insured at the time of the transfer and the significant increment which would be received on the death of the insured; that, shortly before the policy was transferred, the taxpayer had

paid a substantially higher price for the insurance than its cash surrender value; and that there was no evidence that the policy could not have been sold, albeit in a limited market, at its replacement value or at least at a price in excess of its cash surrender value . . . .

"The emphasis by the majority on the fact that the estate and the beneficiaries may continue to own the mutual fund shares and thereby enjoy the benefit of ownership is, in my opinion, wholly misplaced. These possibilities exist with respect to every type of security. If the majority standard is correct, it would be no less 'appropriate' to use replacement cost with respect to marketable securities of all kinds. This, however, is simply not the law. That there may be an equivalence of replacement cost and fair market value in some situations does not justify the substitution of the former for the latter as the criterion in other situations where different considerations are involved.

"The plain fact is that, on the record in this case, petitioner could not dispose of the open-end investment company shares except by way of a sale to the open-end investment companies at the redemption price. That price was all that petitioner could obtain. It is the total amount obtainable by the seller from the available actual purchaser, not the price which a theoretical purchaser would pay another seller, which should control."

Estate of Wells was affirmed as *Reuhlmann v. Commissioner*, (1969) 6 Cir. 418 F. 2d 1303. It was said:

"Petitioner contends that the redemption price should be the determinant of value because that price represents the amount which the decedent or the estate would have received had the shares been sold on the valuation date. However, this is not necessarily the only criterion of value for estate tax purposes.

Value may be determined by an objective standard if it is not unreasonable. The hypothetical 'willing buyer' and 'willing seller' are presumed to act objectively based upon their knowledge of the relevant facts . . . .

". . . In United States v. Correll, 389 U.S. 299, 88 S. Ct. 445, 19 L. Ed. 2d 537 (1967), the court has furnished these guidelines for a court reviewing a Treasury regulation:

> '"Alternatives to the Commissioner's . . . rule are of course available. Improvements might be imagined. But we do not sit as a committee of revision to perfect the administration of the tax laws. Congress has delegated to the Commissioner, not to the courts, the task of prescribing "all needful rules and regulations for the enforcement" of the Internal Revenue Code.'"

In *Howell v. United States*, (1968) (D.C. Ind.) 290 F. Supp. 690, the question arose in determining value of investment trust shares for gift tax purposes where a similar tax regulation was involved. Relying upon the life insurance analogy and the principles of *Guggenheim v. Rasquin*, (1941) 312 U.S. 254, which considered the valuation of life insurance policies, and relying on *Estate of Wells*, supra, the regulation was held to be reasonable. The Seventh Circuit affirmed in *Howell v. United States*, (1969) 414 F. 2d 45, and, again, principal reliance was placed on *Guggenheim* and *Estate of Wells*.

The government is presently appealing two cases in which it did not fare as well. In *Davis v. United States*, (1969) (D.C. Calif.) 306 F. Supp. 949, the regulation was held unreasonable and invalid. It was reasoned:

> ". . . Shares in an open-end investment company are valued in the same manner as those certain life insurance and annuity contracts which are covered by Reg. 20.2031-8 (a). Yet unlike those life insurance

and annuity contracts, shares in an open-end investment company do not have any value over and above the redemption price offered by the company. To value the shares of an open-end investment company at the public offering price rather than the redemption price is, in essence, an estate tax penalty for investing in open-end investment shares rather than some other type of property.

"The basic fair market valuation rule cannot be applied to open-end investment shares by simplistically viewing the estate of the decedent as a 'willing seller' and the open-end investment company as a 'willing buyer'. The difficulty in rigidly applying the 'willing buyer and seller' slogan to value open-end investment company shares is that there are two separate markets that must be distinguished. The first market, and the one the Secretary of the Treasury has decided to focus on, merely because it gives the greatest amount of tax revenue to the federal government, is the public sales market where the offering price of the shares consists of the net asset value of the portfolio securities held by the open-end investment company plus a sales commission. The other market consists of the buying market where the shareholders who want to dispose of their shares must sell them to the open-end investment company that has guaranteed it will purchase the shares at a redemption price equal to the net asset value of the portfolio securities held by the company. The difference in the price in the two markets is the sales commission, and since the only price the estate can get is what the investment company has guaranteed it will pay, the redemption price reflects the true and actual value of the open-end investment company shares to the estate. To include the fictitious sales commission in the value of the shares to the estate is to create an artificial value that cannot possibly be obtained by the estate in any readily accessible, realistic market.

"This dual market situation in open-end investment company shares is analogous to a stock or bond that

> is subject to a binding contract to purchase. The Secretary of the Treasury has covered the estate tax valuation of securities subject to a binding contract to purchase in Treas. Reg. 20.2031-2(h)(1958), which specifies that if a person in a bona fide business arrangement 'is not free to dispose of the underlying securities at other than the contract price,' that price can be used to determine the value of the securities for estate tax purposes. Although there is no binding contract in this case, the rationale of Treas. Reg. 20.2031-2(h) (1958) should apply to open-end investment shares because the redemption price offered by the company truly represents the only realistic value that the estate can obtain for the shares of the open-end investment company."

In *Davis*, Judge Hauk discussed both *Estate of Wells* and *Howell*, and, in electing not to follow those decisions, said:

> "We come away from careful analysis of both *Wells* and *Howell* strengthened in our conviction that the only true, actual, realistic value to the estate of the open-end investment company shares held by the Davis Estate here is the redemption price guaranteed by the investment company, Affiliated Fund Inc."

Cartwright v. United States, (1971) (D.C. N.Y.) 323 F. Supp. 769, discusses all of the foregoing cases, and, following the reasoning of *Davis*, holds the regulation to be unreasonable and invalid. Judge Curtin adopted the two market approach and said:

> "If an individual acquires shares in the funds through purchase, he realizes at the time of the original acquisition that he is paying a load charge. He further understands that, if he later wants the company to redeem the shares, they will be redeemed on the date of redemption at the net asset value. There are no restrictions on the transferability of shares in the funds, but they are not sold in the securities market. The ordinary and only practical method of disposition is redemption. If the holder disposes of these shares during his lifetime, tax computation is

based upon net asset value.

. . . . . .

"Prior to the promulgation of regulation 20.2031-8(b) (1963), effective after April 10, 1963, there was no regulation specifying how shares in mutual funds should be valued for estate tax purposes. From 1940, when the investment company act became effective, until the early 1960's, the Commissioner had no fixed policy for the valuation of mutual funds. During this period of time, the taxpayer could value the shares at redemption price if he desired. In about the year 1962, some revenue agents demanded that mutual fund shares in estate tax returns be valued at the asked price or at the mean between the bid and the asked price. However, after taxpayers filed refund actions, the government accepted the bid prices as the fair market value and settled the cases.

. . .

(Judge Curtin then discusses valuation principles and the theories advanced by the government in support of its argument.)

"History lends little support to the government's argument that the regulation was designed to bring the valuation of mutual fund shares into harmony with such decisions as Guggenheim v. Rasquin . . . . It is clear that the regulation cannot be deemed a contemporaneous construction of the statute."

We agree with all that is said in *Davis* and *Cartwright* except that we do not think that there are "two markets" for investment trust shares. In our view, there is only one market. That is the market for the original sale of the shares, but the sales contract is that the buyer buys at one price, and as part and parcel of the same contract, agrees to sell at a lesser price, as the latter price may be affected by changes in market conditions. Viewing the contract in this light meets every test of the "willing buyer-willing seller" definition usually applied in the determination of market value. The "willing buyer" is the fully informed person who agrees to buy the shares, agreeing at that time to sell them to the fund – the only available repurchaser – at the redemption price. The "willing

seller" is the fund which sells the shares at market value plus a load charge, and which agrees to buy the shares back at market less the load charge. That is the market, and it is the only market. It is a market made up of informed buyers and an informed seller, all dealing at arm's length.

This is a market concept not unknown to the law. It is one sometimes encountered in eminent domain proceedings. It is not unusual to run across a sale and purchase of land where the purchaser has negotiated a contract giving him the right to sell the land back to the original grantor at a lesser price under certain conditions. For example, an oil company may buy land for service station use at an agreed price, but the contract is made subject to future zoning. If zoning is not obtained, the parties agree that the grantor must buy the land back at something less than the purchase price. If the government condemns the land, and if zoning has not been obtained, or if the property owner can't prove the reasonable probability of obtaining zoning, the government pays only the resale price for the land. Of course, what the government may be willing to pay in a condemnation case is in no way controlling in determining the validity of a tax regulation, but the illustration does serve to demonstrate that contracts of purchase coupled with contracts to resell are not unknown, and that when it is to its advantage, the government insists that it must be no more than the resale price.

Admitting that we do not sit as a court of review to establish the perfect tax system, logic permits no conclusion other than that this regulation is unreasonable. It taxes a value which does not exist. The load charge which is being taxed is a seller's expense; it is not an increment of value transferred to the purchaser. It differs not from any other sales expense. It would be no more illogical to say that advertising expense incurred by a seller of real estate should be tacked on to the fair cash market value of that real estate. Certainly the Commissioner would not be so bold as to contend that the cost of a non-transferable title insurance policy should be added to the fair cash market value of real estate, but the value of investment trust shares comes far closer to being of the same breed of cat as the value of real estate than does the value of such shares come to being of the same breed as the purchase

price of a life insurance policy. The Commissioner cannot cross-breed life insurance and investment trust shares by the simple expedient of discussing them in separate paragraphs of a single regulation.

Banks and trust companies almost always make a charge for setting up a revocable trust to be managed by the bank or trust company. This is a load charge made by the bank, just as an investment trust loads the sale price of its shares. Upon revocation of the trust, the settlor can't recover the setup charge, but, upon death of the settlor, the setup charge isn't added to the value of the securities taxable in his estate. Upon the sale of shares in an investment trust, the owner can't recover the load charge, but the load or setup charge is illogically and unreasonably added to the value of his shares. Any half hearted differentiation between a setup charge for a revocable trust set up with a bank and a load charge made by an investment trust would be to us a distinction without a difference, because the bank's setup charge adds nothing to value and neither does the investment trust's load charge. The only real purpose of the regulation is to extract more money from the taxpayer, but when the underlying theory of a tax is to tax value, a regulation taxing something which has no value cannot be upheld. The regulation is discriminatory and it is unreasonable. The value of decedent's shares in The Colonial Fund on October 2, 1966, was $12.00075 per share, or $6,892.31 for the 574 shares of The Colonial Fund owned by decedent on the date of her death.

As has been noted, the Commissioner valued the Espy Ice stock at $37.44 per share, and the Court has determined that its value was $41.75 per share. The Commissioner valued the City Ice stock at $450.00 per share, and the Court has determined that its value was $306.00 per share. Lastly, the Commissioner fixed the value of the Colonial Fund shares at $12.64 per share, and the Court determined the value of those shares to be $12.00075. These determinations have caused a post trial disagreement between the parties as to the judgment which should be entered.

Plaintiff reasons that she should have the benefit of the portion of the case she has won, but that she should not pay, directly or indirectly, any additional tax because she lost part

of the case. She says that taking into account her partial victory on the City Ice stock and on the Colonial Fund shares, she is entitled to a judgment of $6,093.65. Defendant, on the other hand, while admitting that it would not be entitled to an affirmative judgment against plaintiff, says that it is entitled to the benefit of the overall result of the valuation determinations made by the Court. Defendant relies on *Lewis v. Reynolds*, (1932) 284 U.S. 281, 283, where it was said:

> "It follows that the ultimate questions presented for decision, upon a claim for refund, is whether the taxpayer has overpaid his tax. *This involves a redetermination of the entire tax liability*. While no new assessment can be made, after the bar of the statute has fallen, the taxpayer, nevertheless, is not entitled to a refund *unless he has overpaid his tax*." (emphasis supplied)

The Court has determined the entire tax liability, and plaintiff has not shown that she has overpaid her tax. To the contrary, under the determinations made by the Court, plaintiff's tax would be $197,737.30, and she paid $190,082.97. No new assessment can be made, and defendant is entitled to no monetary judgment in its favor, because "the bar of the statute has fallen." But, plaintiff is not entitled to a judgment in her favor, because she has not overpaid her tax. Nor does defendant's answer change this result. The pleadings merged in the pretrial order, and defendant's present position is clearly available under that order.

Accordingly, judgment shall enter dismissing plaintiff's complaint and costs are awarded defendant.

Dated at Denver, Colorado, this 20th day of December, 1971.

(s) Fred M. Winner
United States District Judge

Appendix B

PUBLISH

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

SEPTEMBER 1973 TERM

BERNICE ESPY HICKS, as Special Fiduciary of the Estate of Pearle M. Espy, Deceased,	)	
Plaintiff-Appellant,	)	
and	)	
FINANCIAL INDUSTRIAL FUND, INC., FINANCIAL INDUSTRIAL INCOME FUND, INC., FINANCIAL DYNAMICS FUND, INC., and FINANCIAL VENTURE FUND, INC.,	)	NO. 72-1360
Intervenors,	)	
v.	)	
UNITED STATES OF AMERICA,	)	
Defendant-Appellee.	)	

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
(D.C. NO. C-2396)

Theodore T. Peck, Denver, Colorado (Wagner and Wyers, Denver, Colorado, on the brief) for Plaintiff-Appellant

Leland E. Modesitt and Gorsuch, Kirgis, Campbell, Walker and Grover, Denver, Colorado, submitted a brief on behalf of the Intervenors

Wesley J. Filer, Department of Justice, Washington, D.C., (Scott P. Crampton, Assistant Attorney General, Washington, D.C.; Meyer Rothwacks and David English Carmack, Attorneys, Department of Justice, Washington, D.C.; and James L. Treece, United States Attorney, Denver, Colorado, on the brief) for Defendant-Appellee

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Before HILL, HOLLOWAY and DOYLE, Circuit Judges

HOLLOWAY, Circuit Judge

Bernice Espy Hicks as special fiduciary brought this suit for refund of estate taxes paid on the estate of Pearle M. Espy. The District Court found that the fiduciary had not established that she was entitled to a refund and dismissed. 335 F. Supp. 474. The fiduciary appeals, arguing that the Court erred: (1) by substituting current liquidation value for book value in considering the real estate holdings of two corporations whose stock values were in issue; and (2) by allowing a decreased taxable value on one stock asset to be offset by an increased taxable value on another, without any such recoupment by setoff being raised in the Government's answer.[1]

The stock whose value is in issue is that of two closely held Colorado corporations. Espy Ice Company (Espy) and City Ice Company (City). At her death in 1966 decedent owned outright 7,600 shares in Espy and held a power of appointment over an additional 3,500 shares of Espy stock. She also had a power of appointment of 138 shares of City stock and Espy owned another 1,140 shares of City stock. Considering all the shares thus controlled, the decedent held approximately 52% of the outstanding stock of Espy and approximately 49% of that of City.

In his deficiency assessment the Commissioner valued the Espy stock at $37.44 per share and the City stock at $450.00 per share. The fiduciary's complaint in the District Court alleged by totals that these valuations had been placed on the stocks by the Commissioner. In its answer the Government alleged that the stock had been "properly valued," at the assessed values referred to in the complaint. The pre-trial order reflects that no amendments to the pleadings were made and that the fair market value of the Espy and City stocks were contested issues of fact remaining for decision.

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[1] A further issue was argued below by the principal parties and intervenors as to the validity of the Commissioner's regulation for valuing mutual fund stocks, 26 C.F.R. §20.2031-8(b), and this issue has been briefed by the Government and intervenors on appeal. The issue was decided in favor of the fiduciary by the District Court and the same conclusion has now been authoritatively pronounced. United States v. Cartwright, 411 U.S. 546. In view of the disposition we make on the other issues the argument by the Government on this issue need not be considered.

The fiduciary's valuation witness testified that the value of Espy stock at decedent's death was $13.70 per share and that the City stock was then worth $126.00 per share. He focused largely on recent average earnings and dividend payments, rate of return calculations, and stock book value based on book value of assets. He indicated that the market value of the assets of the closely held corporations would not affect the value of the stock since the companies were not in liquidation. The District Court found that this approach to value was "totally unrealistic" primarily because, in connection with real estate owned by the corporations, he had used the book value of the properties. The Court noted that the witness failed to take into account ". . . any appreciation in value of industrial Denver real property and the sky rocketing value of prime mountain property having potential for subdivision." While the witness was permitted to testify as to his conclusions based on the values he used, the Court did not accept his conclusions.

The Government offered testimony by an expert appraiser on the value of real estate owned by Espy and City. It then also offered proof by another expert on the value of the corporate stocks of these companies. This witness took into consideration the prior testimony on the value of the real property owned by the corporations, along with other factors not now in issue, such as earnings records and the like. His conclusions were that the Espy and City stocks were worth $41.75 and $306 per share, respectively, at the decedent's death. This proof placed the value of the City stock below its valuation in the Commissioner's assessment. However, it placed the Espy stock, of which the decedent held a far greater number of shares, at a valuation above that stated in the assessment.

The District Court accepted the Government testimony as to the values of Espy and City stocks and found that the tax would have been $197,737.30 based on them and the value of other assets of the estate. This exceeded the amount of tax actually paid – $190,082.97. Therefore the Court found that the fiduciary had not established her entitlement to a refund and dismissed the action.

We agree fully with the Court's views expressed in its detailed opinion. Our discussion will be confined to the two principal appellate arguments urged before us.

First the fiduciary argues that the District Court erred by substituting current liquidation value for book value when it considered the value of real estate holdings of Espy and City. The contention is directed at the testimony of the Government witness on the stock values, accepted by the Court, since the witness is said to have given improper consideration to the fair market value of the real property owned by the corporations. The fiduciary says that the market value of the real properties should not have been considered by the expert witnesses or the Court since the corporations were not contemplating sale of any of them. We cannot agree.

The Government's valuation witness explained that he had studied Espy and realized it was not a wholly operating company. He considered the corporation to have three valuable assets apart from the business of vending ice through machines in downtown Denver: the lake property near Toponas; the Espy real estate near Rollinsville, and the shares of City stock owned by Espy. The witness pointed out that the lake property was no longer used for its original purpose of harvesting ice for sale in Denver and that the property could have been sold without affecting the ice business. He gave each of the three Espy assets separate weight based on their fair market values, and also considered the on-going business producing the corporate earnings. In valuing the City stock the Government witness again considered earnings and the fair market value of assets, as well as a discount factor for lack of marketability of the stock.

By contrast the fiduciary's witness focused largely on recent average earnings and dividends of City and Espy, rate of return calculations, and stock book value based on book value of assets. He viewed the market values of assets as immaterial and apparently relied only on book values of them.

We feel the Court's findings, based on acceptance of the Government proof, are fully supported by reason and the record. The valuation of stock in the closely held corporations for tax purposes is a question of fact and the weight to be

given the various evidentiary factors depends on the circumstances of each case. 26 C.F.R. § 20.2031-2(f); Hamm v. C.I.R., 325 F.2d 934, 938 (8th Cir.), cert. denied, 377 U.S. 993; F. A. Gillespie & Sons Co. v. C.I.R., 154 F.2d 913 (10th Cir.), cert. denied, 329 U.S. 781. The value of a closely held corporation's assets and its net worth have generally been recognized as proper factors to be considered. 26 C.F.R. § 20.2031-2(f); see, e.g., Hamm v. C.I.R., supra, Estate of Nathan v. C.I.R. 166 F.2d 422 (9th Cir.); Brooks v. Willcuts, 78 F.2d 270 (8th Cir.). We are convinced that there was no error in taking into the account the various factors that were considered in determining the value of the stocks in question.

Second, the fiduciary contends that the District Court erroneously allowed a decreased tax value to be set off by an increased tax value without any such recoupment by setoff being raised in the pleadings. She says the Government was foreclosed from obtaining the benefit of proof showing a higher valuation for the Espy stock than was used in the Commissioner's assessment. The point is also urged on the theory that the Government's answer made a judicial admission of the correctness of the assessed value of the Espy stock so that the Government is conclusively bound by that value. Again we disagree.

At trial the fiduciary presented her own proof attempting to show that the value of the Espy stock was $13.70 per share. This was below the value of $37.44 per share relied on in the assessment. As noted above, the Government's answer had "admitted" that the stocks had been properly valued in the assessment. Thus the $37.44 value for Espy stock used by the Government in the assessment was before the Court for consideration as an admission.[2]

Government evidence was also offered at trial to show that the value of the Espy stock was $41.75 per share. No

[2]The District Court's opinion referred to the values per share given for the Espy stock in the estate tax return, $25.00; in the assessment, $37.44; by the fiduciary's witness, $13.70; and the Government witness, $41.75. 335 F. Supp. at 476.

objection was then made by the fiduciary based on the theory of a judicial admission, or of a variance from the issues defined in the pretrial order or the pleadings. After trial and the oral announcement of the Court's findings, the Court directed that the parties compute the proper tax under the ruling made. At that point the fiduciary's counsel argued that he thought the Government was limited by its answer in which it was stated specifically that the values fixed by the Internal Revenue Service were correct. Subsequently the Court entered its written findings and judgment based on the Espy stock value of $41.75 per share and other values found.

The issue for trial on the claim for refund was the redetermination of the entire estate tax liability, as the District Court observed. See Lewis v. Reynolds, 284 U.S. 281,283. There was no actual judicial admission removing the issue of the Espy stock value from trial,[3] although the Government's answer was before the Court to be considered as an admission on the Espy stock value. The pretrial order reflects that this issue remained for decision. And in any event the pleadings of the parties would be deemed amended to conform to the proof offered by them. Rule 15(b) F.R.Civ.P.; Hopkins v. Metcalf, 435 F.2d 123 (10th Cir.).

We are satisfied the record shows no prejudice to the fiduciary. She offered her own proof on the issue and made no objection to that of the Government. Since there was no prejudice or unfairness in trial of the issue, the judgment should not be disturbed. Monod v. Futura, Inc., 415 F.2d 1170, 1174 (10th Cir.); Decker v. Korth, 219 F.2d 732, 739 (9th Cir.), cert. denied, 350 U.S. 830; see also Southwestern Investment Co. v. Cactus Motor Co., 355 F.2d 674, 678 (10th Cir.); Christie v. United States, 179 F. Supp. 709 (D. Ore.) (allowing a larger refund than was sought by a taxpayer in his complaint.)

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[3]Such an admission occurs where a proposition of fact is alleged by one party and conceded to be true by the adverse party. See McNamara v. Miller, 269 F.2d 511, 515-16 (D.C.Cir.); Alamo v. Del Rosario, 98 F.2d 328, 330 (D.C. Cir.); IV Wigmore on Evidence, §1059 at 27 (Chadbourn Rev.). Since there was no allegation by the fiduciary that the Espy stock was worth $37.44 per share as assessed, followed by an admission of that value by the Government, the theory is inapplicable.

The fiduciary makes a related argument against Government reliance on the increased Espy stock value above that in the assessment. She says that to allow this permits a barred claim to be used as a setoff or recoupment, relying on Brady v. United States, 24 F.2d 205 (D. Mass.), and other cases. However the issue here was the redetermination of the entire estate tax liability which the fiduciary's refund suit called for, see Lewis v. Reynolds, 284 U.S. 281,283, and no recoupment was involved. Even viewed as a recoupment, reliance on the Espy stock value relating to the same tax liability would not be barred. See Bull v. United States, 295 U.S. 247, 262.[4]

We are convinced that the claims of error are untenable and that the findings and judgment of the District Court are amply supported and proper.

AFFIRMED.

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[4] Although the District Court found that the proper tax was greater than that assessed and paid, the Government there conceded that it was not entitled to an affirmative judgment because the statute of limitations precluded further assessment.

Appendix C

U.S. Treasury Regulation 26 C.F.R. §20.2031-2 - Valuation of stocks and bonds

(f) Where selling prices or bid and asked prices are unavailable. If the provisions of paragraphs (b), (c), and (d) of this section are inapplicable because actual sale prices and bona fide bid and asked prices are lacking, then the fair market value is to be determined by taking the following factors into consideration:

(2) In the case of shares of stock, the company's net worth, prospective earning power and dividend-paying capacity, and other relevant factors.

Some of the "other relevant factors" referred to in subparagraphs (1) and (2) of this paragraph are: the good will of the business; the economic outlook in the particular industry; the company's position in the industry and its management; the degree of control of the business represented by the block of stock to be valued; and the values of securities of corporations engaged in the same or similar lines of business which are listed on a stock exchange. However, the weight to be accorded such comparisons or any other evidentiary factors considered in the determination of a value depends upon the facts of each case. Complete financial and other data upon which the valuation is based should be submitted with the return, including copies of reports of any examinations of the company made by accountants, engineers, or any technical experts as of or near the applicable valuation date.